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PP RUEHIK RUEHLN RUEHPD RUEHSK RUEHVK RUEHYG
DE RUEHKV #0227/01 0331512
ZNR UUUUU ZZH
P 021512Z FEB 09
FM AMEMBASSY KYIV
TO RUEHC/SECSTATE WASHDC PRIORITY 7190
INFO RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUCPDOG/DEPT OF COMMERCE WASHINGTON DC
RUCNCIS/CIS COLLECTIVE
RUEHZG/NATO EU COLLECTIVE

UNCLAS SECTION 01 OF 03 KYIV 000227

SENSITIVE
SIPDIS

DEPT FOR EUR/UMB, EEB/OMA

E.O. 12958: N/A

TAGS: [EFIN](#) [ECON](#) [ETRD](#) [PREL](#) [PGOV](#) [XH](#) [UP](#)

SUBJECT: UKRAINE FINANCE MINISTER'S SECRET PREDICTIONS

REF: KYIV 169

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Summary

¶1. (SBU) In a leaked letter to PM Tymoshenko, Ukraine's Minister of Finance Viktor Pynzenyk has predicted the "very real" possibility of Ukraine's total economic collapse. Internet newspaper Ukrainska Pravda published the classified document, addressed to Prime Minister Yulia Tymoshenko and the Cabinet of Ministers, in which Pynzenyk equates Ukraine's current fiscal and monetary crises to the country's economic traumas in 1994.

¶2. (SBU) On January 28, following the 24 page letter's leak and subsequent, contradictory public statements on its authenticity, Pynzenyk was admitted to a Kyiv hospital, reportedly due to a heart condition. Scuttlebutt on Pynzenyk's future has since dominated the air waves and newspapers, even exceeding attention given to his discredited colleague, National Bank of Ukraine Governor Volodymyr Stelmakh (reftel). Pynzenyk's assistant told us on January 29, however, that the Minister will "be back soon," while cooperation with the IMF team continues "on track." End summary.

Minister's Dire Predictions

¶3. (SBU) Pynzenyk's letter to PM Tymoshenko and the Cabinet of Ministers, dated January 6 but leaked to the media and published on January 27, contains strong language about an "extremely threatening" economic situation. The biggest fears, according to the letter, are a recurrence of the 1994 crisis, when the country's monthly inflation grew 70 to 100 percent, currency reserves fell perilously low, and many large factories sat idle. The major concerns in 2009, according to the letter, are an untenable budget, collapsing GDP, falling industrial production, and mounting foreign debt.

¶4. (SBU) Citing Ministry of Finance estimations, the letter describes budget revenues that will amount to UAH 225.3 billion (\$28.9 billion), or UAH 85 billion (\$10.9 billion) less than had been first projected by the Ministry. New laws that increase excise duties only slightly offset the deficit. (Note: Subsequent to the date of the letter, another bill passed in the Rada that would have increased import tariffs by 13 percent. Under pressure from business groups, however, President Viktor Yushchenko vetoed the bill, and it now awaits an override vote in parliament. End note.) Local budget performance

is hardly better, with over 425 municipalities failing to fulfill their plans for revenue collections.

15. (SBU) The letter attributed to Pynzenyk states that all existing revenues into the state treasury will be needed to cover non-discretionary spending, leaving no room for discretionary expenses or a larger than expected shortfall in the pension fund. It continues: "(E)nergy payments, medicines, food, debt servicing (that is a big threat), science, etc. will not be financed. And under such conditions, the budget includes a provision for bringing the minimum wage to the subsistence level. But we can't even pay at existing levels...Proposals to balance the budget through tax increases put unacceptable pressure on the economy. Ukraine will not survive with the current 2009 budget."

16. (SBU) The letter recounts previously published statistics, such as the 14 percent year-on-year GDP drop and 28.6 percent drop in industrial output in November (including declines in machine-building of 38.8 percent and metallurgy of 48.8 percent). Another worrisome signal was the decline in electricity consumption, which shrank 19 percent in October, 35 percent in November, and 38 percent in December. The letter indicates that the Ministry of Finance's earlier predictions of minus 5 percent GDP growth in 2009 are too optimistic, projecting a 7-10 percent drop in GDP from the first quarter of 2008 to the first quarter of 2009 alone.

17. (SBU) Pynzenyk indicated that Ukraine's budgetary and macroeconomic problems are so deep that the country would

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have trouble attracting foreign capital, even in the best of times. His letter quotes a number of figures, such as UAH 31.7 billion (\$4.05 billion) to service public sector debt, in addition to the UAH 50 billion (\$6.4 billion) he presumes Ukraine needs for bank recapitalization. "Countries with such deficits as ours are not lent money," he surmised.

How to Fix the Situation?

18. (SBU) The letter proposes a cut in government wages by an average of 20 percent, with minister and Rada deputy salaries to be halved during the crisis. The Ministry of Finance would also cancel all superfluous benefits for public officials, including official vehicle and cell phone use and non-essential travel. Pension outlays and subsidies would be reformed and targeted, and the government would take over the social insurance fund during the crisis period to protect rising numbers of unemployed. The author writes: "It is not normal for poor and rich people to consume cheap Ukrainian gas at an equal price (or receive the same rates) for utility services. And free books and school food should be provided only to families with low incomes." The letter also proposes increases in the percentage of students paying university tuition (as opposed to receiving full-ride scholarships).

Dissecting the Letter's Authenticity

19. (SBU) While Pynzenyk and his assistant did not directly acknowledge Ministry authorship of the letter, Kyiv-based analysts, journalists, and well-known politicians have all weighed in on its authenticity and significance. Even former Rada speaker Arseniy Yatseniuk called the letter's choppy and blunt Ukrainian writing "characteristically Pynzenyk," equating the "psychology" of the prose with that of the anxious, chain smoking Minister.

110. (SBU) The 24 page letter is replete with graphs and statistics, similar to a presentation on the world

financial crisis the Minister gave to G-7 ambassadors on December 19. At that time, Pynzenyk described a recipe for worsening global conditions and a particular deterioration in the Russian economy that would have an impact on Ukraine. Pynzenyk's focus on falling GDP, declining industrial production numbers, and Russian financial difficulties related to falling energy prices and a highly leveraged banking sector has turned out to be remarkably prescient.

The Minister's Future

¶11. (SBU) Although two press releases, one by the Cabinet of Ministers and the other by the Ministry of Finance, provide conflicting details on the alleged origins of the letter, both denounced its leak as a "provocation." Our sources in the Ministry of Finance tell us there is speculation among Ukrainian officials that Pynzenyk might be removed because of the letter. Cynical observers note that disgraced politicians often seek refuge in hospitals or undisclosed vacation destinations, and now both Pynzenyk and National Bank of Ukraine Governor Stelmakh (on a January-long holiday) have disappeared from the public eye. Rumors aside, the Minister's assistant Ivan Yurik confirmed that Pynzenyk had been hospitalized, and he expressed hope the Minister would be out soon. Negotiations with the IMF continue "on track" in the Minister's absence, said Yurik.

¶12. Comment. From our previous encounters with Pynzenyk, and from correspondence and presentations he has authored in the past, the didactic style of the letter almost undoubtedly can be attributed to the Minister. He has a history of pessimistically taking the worst case scenario, focusing on detailed points, and stressing their importance in a manner that can come across to some as exaggerated.

¶13. However, Pynzenyk's now three-week-old projections do not appear embellished to us. Although he has been notably vilified since the letter's release, Pynzenyk was already considered to be on the periphery of the GOU's crisis response team. Perhaps the most alarming element of the Pynzenyk letter, therefore, is the fact that its author is the only senior Ukrainian official whose baseline forecasts parallel those we have heard from private economic analysts

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in Kyiv. While the letter did not contain specific GDP projections for all of 2009, Pynzenyk allegedly concluded: "The country is in danger. The citizens are in danger. Authority (in government) is not a prize...I want to say it again: there is still a way out of the difficult situation. But we have almost no time. Unless adequate measures are taken, the situation will overtake the country in a month or two." It just may be that bad. End comment.

TAYLOR